

**SUMMARY OF THE REGULAR MEETING OF THE  
ARIZONA STATE RETIREMENT SYSTEM  
INVESTMENT COMMITTEE**

**HELD ON**

**Wednesday, February 6, 2008**

**3:30 p.m.**

The Investment Committee (IC) of the Arizona State Retirement System (ASRS) met at 3300 N. Central Avenue, 14th Floor Conference Room, Phoenix, Arizona 85012. Mr. Lawrence Trachtenberg, Chair of the IC, called the meeting to order at 3:33 p.m., MST.

The meeting was teleconferenced to the ASRS Tucson office, 7660 East Broadway Boulevard, Suite 108, Tucson, Arizona 85710.

**1. Call to Order; Roll Call; Opening Remarks**

Present:       Mr. Lawrence Trachtenberg, Chair  
                  Mr. Christopher Harris  
                  Mr. Thomas Connelly  
                  Mr. James McLaughlin

A quorum was present for the purpose of conducting business.

Mr. Lawrence Trachtenberg stated agenda item 4 would be discussed first, to accommodate the schedule and allow the participation of Mr. Thomas Connelly.

**2. Presentation, Discussion, and Appropriate Action Regarding the ASRS Investment Management Governance Structure, Decision-Making Processes, and Investment Committee Charter**

Mr. Trachtenberg introduced the topic. Mr. Paul Matson, Director, outlined four main points for discussion: 1) public markets – how the ASRS hires investment managers, 2) private equity and real estate protocols, 3) reporting relationship with various contractors, 4) policies and procedures.

Mr. Trachtenberg noted that the Private Equity Committee and Real Estate Committee both include trustees, while ensuring no quorum, and do not go on to the Board for approval of items discussed. He asked all to consider if this is still a good process. Mr. Terry Dennison, Worldwide Partner, Mercer Investment Consulting, Inc., said that Boards in the public world used to exercise manager hiring and termination decisions, but have now devolved that power, making the process cleaner and faster. He recommended that the ASRS devolve some of the decision-making process to staff, particularly in light of the capability staff has, for the sake of efficiency. From a philosophical governance perspective, if the Board does all of the oversight, then they are overseeing themselves with the current public markets processes.

Mr. Christopher Harris said there should be a balance of effectiveness and governance, and agreed that going to the Board with hiring/firing decisions is not the best use of time. Mr. Thomas I. McClory, Assistant Attorney General, noted that statute allows the Board to delegate hiring/firing to the Director, not to any Committee. Mr. Gary R. Dokes, Chief Investment Officer (CIO), noted that those decisions now reside with the Board or Real Estate and Private

Equity Committees. Further discussion ensued regarding other organizations' Board structures and possible implications of various changes to the ASRS Board and Committee procedures.

Mr. Connelly left the meeting at 4:47 PM.

### **3. Presentation and Discussion, and Appropriate Action Regarding the Contracts of Franklin Portfolio Associates and State Street Global Advisors, ASRS U.S. Equity Large Cap Managers**

Mr. Dokes introduced the topic, explaining that Franklin's ASRS mid-cap equity mandate was terminated in December due to the Investment Management Division's (IMD) re-assessment of Franklin's quantitative stock selection model and an anticipation of further portfolio-to-benchmark underperformance. It was noted in the December justification memorandum to terminate Franklin's mid cap, that Franklin's large cap mandate would be re-evaluated at year-end 2007. The ASRS has significant concerns regarding Franklin's quantitative stock selection model. There is also anticipation of continued poor portfolio performance relative to their S&P 500 Index benchmark.

Regarding State Street Global Advisors, there are significant organizational concerns and moderate concerns regarding their ability to add value moving forward. Given the litigation risk the firm faces due to the performance of its active U.S. fixed income strategies during 3Q2007, the firm is likely to be in the headlines for the foreseeable future. This may lead to general reputational damage and a higher than normal risk of personnel departures across all levels of the organization, including investment staff. In fact, on December 17, eight members of the Global Active Equity team departed for another investment management firm. Mr. Dennison noted Mercer's agreement regarding the organizational concerns.

The rationale for transitioning the Franklin and State Street portfolios to E2 is based on the following: 1) it would provide for more efficient cash flow management as it primarily relates to the anticipated multi-fundings of ASRS real estate and private equity commitments, and 2) it would provide the opportunity to generate incremental alpha, with low active risk.

Passive/Active: The reallocation of the Franklin and State Street portfolios to the passive E2 portfolio will increase the large cap passive allocation from 60% to 69%. This remains within the policy target of 65% +/- 10%.

Growth/Value: In dollar terms, the reallocation of State Street (value) to the core E2 portfolio will result in a modest growth bias. In addition, there will be a slight reduction in active risk, as the tracking error for both Franklin and State Street is low, in the 2-3% range.

The choice not to conduct a large cap active search is based on ASRS experience, academic studies, and various consultants' analyses supporting the efficiency of the large cap equity asset class, i.e., favors passive over active management.

**Motion:** Mr. Christopher Harris moved to recommend that the Board:

- Terminate Franklin Portfolio Associates (Franklin) and State Street Global Advisors (State Street), ASRS U.S. Equity Large Cap Managers.
- Transition both portfolios, whose aggregate market value is approximately \$970 million, to E2, ASRS' passive U.S. Large Cap Equity portfolio.

Mr. Jim McLaughlin seconded the motion.

By a vote of 3 in favor, 0 opposed, and 1 absent, the motion was approved.

#### **4. Presentation, Discussion, and Appropriate Action Regarding the Status of the ASRS Real Estate and Private Equity Programs**

Mr. Dokes introduced the topic. Mr. Richard Henkel, Private Equity Manager, gave an update on the Private Equity program. It is expected that there will be an additional \$995 million in commitments in 2008. He said an RFP has been issued for legal consulting and there are ten responses being evaluated. Mr. Dokes said there is now \$60 million drawn down in Private Equity and at the end of 2008, there will be \$360 million, 1.5% of the policy target.

Mr. Ethan Hurley, Assistant Private Equity/Real Estate Portfolio Manager, updated the IC on the Real Estate program. There are 22 investment mandates. In the fourth quarter, three new managers were added. Staff worked on Real Estate operational procedures. A considerable amount of time was spent with Townsend, the Real Estate consultant, looking at their *View of the World* and planning for 2008. The ASRS will look at investing in Asia and Europe. Non-core space will also be a focus, as will debt markets, and some follow-on funds. Hotels and the industrial sector will be considered. Mr. Dokes noted that the Real Estate program started in September 2005, and the inception-to-date return is 15%.

#### **5. Call to the Public**

No members of the public requested to speak to the IC.

The meeting adjourned at 5:38 PM.

Respectfully submitted,

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Lisa Hanneman, Secretary

Date

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Gary R. Dokes, Chief Investment Officer    Date